

this paragraph would also be satisfied if a financial institution establishes and maintains a permanent subsidiary ledger reflecting an account for the reserve for losses on loans established pursuant to section 585(a) (or former section 166(c)) provided the balance in such account can be readily reconciled with the balance of the reserve for losses on loans for financial statement purposes maintained in any other ledger. The permanent records maintained pursuant to this section must reflect any changes in the amount initially added to the reserve for losses on loans and the amount finally determined by the taxpayer to be a reasonable addition to the reserve for losses on loans.

(Sec. 585(b)(4), of the Internal Revenue Code of 1954 (83 Stat. 618; (26 U.S.C. 585(b)(4))))

[T.D. 7532, 43 FR 3114, Jan. 23, 1978, as amended by T.D. 8513, 58 FR 68757, Dec. 29, 1993]

§ 1.585-4 Reorganizations and asset acquisitions.

(a) *In general.* In computing a reasonable addition to the reserve for losses on loans for the first taxable year ending after a transaction to which section 381(a) applies and for subsequent taxable years, the separate reserves for losses on loans, the amount of loans outstanding, the total bad debts sustained (adjusted for recoveries), and the amount of eligible loans outstanding of the distributor or transferor corporation and the acquiring corporation (or, in the case of a consolidation, the transferor corporations) shall be combined for all applicable years. Thus, for example, in applying § 1.585-2(c)(1)(i) for the first taxable year ending after the distribution or transfer, the total bad debts sustained during the 5 preceding taxable years are the sum of the bad debts sustained by the acquiring corporation for the 5 preceding taxable years and bad debts sustained by the distributor or transferor corporation for the taxable year ending on the date of distribution or transfer and the 4 preceding taxable years.

(b) *Base year and base year amounts of acquiring corporation—(1) Base year.* For transactions to which section 381(a) applies, the base year of the acquiring corporation for the first taxable year ending after the date of distribution or

transfer shall be the last taxable year ending on or before the date of distribution or transfer. The balance of the reserve, the amount of loans outstanding, and the amount of eligible loans outstanding at the close of such base year shall be determined in accordance with the provisions of subparagraph (2)(i) of this paragraph. For taxable years subsequent to the first taxable year ending after the date of distribution or transfer, the base year of the acquiring corporation shall be the more recent of the base year provided by the first sentence of this subparagraph or the base year provided by § 1.585-2(e)(1). If § 1.585-2(e)(1) provides the more recent base year, the balance of the reserve for losses on loans, the amount of loans outstanding, and the amount of eligible loans outstanding shall be determined at the close of such base year without regard to this paragraph.

(2) *Base year amounts—(i) Method of determination.* The balance of the reserve for losses on loans, the amount of loans outstanding, and the amount of eligible loans outstanding at the close of the base year provided by the first sentence of subparagraph (1) of this paragraph shall be the total of such amounts of the distributor or transferor corporation and the acquiring corporation (or, in the case of a consolidation, the transferor corporations) at the close of what would have been their respective base years determined under § 1.585-2(e)(1) if the distribution or transfer to which section 381(a) applies had not occurred, except that the method (experience or percentage) used or adopted by the acquiring corporation to determine its reasonable addition to a reserve for losses on loans for the first taxable year ending after the date of the distribution or transfer shall be considered to be the method that the distributor or transferor corporation (or, in the case of a consolidation, that the transferor corporation) would have used or adopted for its first taxable year ending after the date of distribution or transfer if the distribution or transfer had not occurred.

(ii) *Examples.* The application of the rule provided by this subparagraph may be illustrated by the following examples:

Example 1. The X Corporation and the Y Corporation are commercial banks both of which have a calendar year as a taxable year. Both X and Y adopted the reserve method of accounting for bad debts prior to July 11, 1969. For the taxable year 1970 through 1973, X and Y determined their reasonable additions to a reserve for losses on loans as defined in § 1.585-2(e)(2) under the percentage method. On June 30, 1974, the X Bank is merged into the Y Bank; for its short taxable year ending on June 30, 1974, X determines its reasonable addition under the percentage method. If, for the taxable year ending on December 31, 1974 (the first taxable year ending after the date of distribution or transfer), Y determines its reasonable addition to a reserve for losses on loans under the percentage method, then at the close of the base year the reserve balance, the amount of outstanding loans, and the amount of eligible loans outstanding are the sum of X's and Y's respective amounts at the close of the taxable year ending December 31, 1969 (the base year of both X and Y determined under § 1.585-2(e)(1) as if the distribution or transfer had not taken place). If, instead of the above, Y adopts the experience method of determining its reasonable addition to a reserve for losses for the taxable year 1974, then at the close of the base year (1973) the reserve balances, the amount of loans outstanding, and the amount of eligible loans outstanding are the sum of X's respective amounts at the close of its short taxable year ending on June 30, 1974 (X's last taxable year before its (Y's) most recent adoption of the experience method) and of Y's respective amounts at the close of its taxable year 1973 (Y's last taxable year before its most recent adoption of the experience method).

Example 2. The M Corporation and the N Corporation are commercial banks. M has a fiscal year ending September 30, as its taxable year and N has a calendar year as its taxable year. Both M and N adopted the reserve method of accounting for bad debts prior to July 11, 1969. For the taxable years ending in 1970, 1971, and 1972, M determined its reasonable addition to a reserve for losses under the percentage method; for the taxable year ending in 1973 M adopted the experience method. For the taxable years 1970 through 1973 N determined its reasonable addition under the percentage method. M is merged into N on June 30, 1974, and for its short taxable year ending on June 30, 1974, M determines its reasonable addition under the experience method. If, for the taxable year ending on December 31, 1974 (the first taxable year ending after the date of distribution or transfer), N determines its reasonable addition to a reserve for losses under the percentage method, then at the close of the base year (1973) the reserve balance, the amount of loans outstanding, and the amount of eli-

gible loans outstanding are the sum of M's respective amounts at the close of (a) if M had a reserve deficiency as of June 30, 1974, its short taxable year ending on June 30, 1974 (M's last taxable year before its (N's) most recent adoption of the percentage method), or (b) if M did not have a reserve deficiency, the taxable year ending on September 30, 1969, and N's respective amounts at the close of its taxable year 1979. If, instead of the above, N adopts the experience method for the taxable year 1974, then at the close of the base year the reserve balance, the amount of outstanding loans, and the amount of eligible loans outstanding are the sum of M's respective amounts at the close of its taxable year ending on September 30, 1972 (the last taxable year before M's most recent adoption of the experience method), and N's respective amounts at the close of the taxable year 1973 (the last taxable year ending before N's most recent adoption of the experience method).

(Sec. 585(b)(4), of the Internal Revenue Code of 1954 (83 Stat. 618; (26 U.S.C. 585(b)(4))))

[T.D. 7532, 43 FR 3114, Jan. 23, 1978]

§ 1.585-5 Denial of bad debt reserves for large banks.

(a) *General rule.* For taxable years beginning after December 31, 1986, a large bank (as defined in paragraph (b) of this section) may not deduct any amount under section 585 or any other section for an addition to a reserve for bad debts. However, for these years, except as provided in § 1.585-7, a large bank may deduct amounts allowed under section 166(a) for specific debts that become worthless in whole or in part. Any large bank that maintained a reserve for bad debts under section 585 for the taxable year immediately preceding its disqualification year (as defined in paragraph (d)(1) of this section) must follow the rules prescribed by § 1.585-6 or § 1.585-7 for changing from the reserve method of accounting for bad debts that is allowed by section 585, to the specific charge-off method of accounting for bad debts, in its disqualification year. However, except as may be provided otherwise in regulations prescribed under section 593, the rules prescribed by §§ 1.585-6 and 1.585-7 do not apply to a large bank that maintained a reserve for bad debts under section 593 for the taxable year immediately preceding its disqualification year.

(b) *Large bank—(1) General definition.* For purposes of this section, a large